

DOCUMENT RESUME

01127 - [A1051683]

Federal Supply Service Not Buying Goods at Lowest Possible Price. PSAD-77-69; B-114807. March 4, 1977. 23 pp.

Report to the Congress; by Robert F. Keller, Acting Comptroller General.

Issue Area: Federal Procurement of Goods and Services: Reasonableness of Prices Under Negotiated Contracts and Subcontracts (1904).

Contact: Procurement and Systems Acquisition Div.

Budget Function: General Government: General Property and Records Management (804); General Government: Other General Government (806).

Organization Concerned: General Services Administration; Federal Supply Service.

Congressional Relevance: Congress.

Authority: Truth-in-Negotiation Act (P.L. 87-653).

Some contractors charge the Government more for their products than they charge commercial customers who buy smaller or comparable quantities of those products.

Findings/Conclusions: Prices charged the Federal Supply Service (FSS) by 5 of 12 multiple award schedule contractors were much higher than prices charged other customers. This was probably because the FSS did not have procedures for considering the total purchases expected under a contract when evaluating offers and prices. As a result, the FSS did not obtain the volume discounts normally available to other customers. Had it done so, the Government could have saved about \$1.2 million on purchases totaling \$11.2 million from the five contractors. Although sales from FSS contracts amounted to \$840 million, contractors' proposals were rarely independently audited. Sales and discount information submitted on 6 of 15 contract proposals was not accurate, current, or complete. Therefore, the pricing information used by the FSS in evaluating offers and negotiating prices may have been inaccurate. **Recommendations:** The FSS should develop procedures to enable it to obtain discounts given by contractors to other customers buying large quantities of goods and increase its verification of contractors' proposals and audit coverage of completed contracts. The General Services Administration needs to reevaluate its role and adopt the concept that it represents the Government as an entity rather than as individual purchasing units. (Author/QM)

01127

REPORT TO THE CONGRESS



*BY THE COMPTROLLER GENERAL
OF THE UNITED STATES*

Federal Supply Service Not Buying Goods At Lowest Possible Price

General Services Administration

Some contractors charged the Government more for their products than they charged commercial customers who bought smaller or comparable quantities of those products. If the Federal Supply Service had sought and obtained prices comparable to those given other customers, the Government could have saved \$1.2 million on products bought from five contractors.



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-114807


To the President of the Senate and the
Speaker of the House of Representatives

This report discusses the General Services Administration's procurement practices pertaining to its multiple award schedule program.

Our review was made to determine if the procurement practices associated with the negotiation and award of contracts on multiple award schedules resulted in fair and reasonable prices when compared to prices obtained by other customers.

We made our review pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

We are sending copies of this report to the Director, Office of Management and Budget; and the Administrator of General Services.


ACTING Comptroller General
of the United States

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

FEDERAL SUPPLY SERVICE NOT
BUYING GOODS AT LOWEST POSSIBLE
PRICE
General Services Administration

D I G E S T

Some contractors charge the Government more for their products than they charge commercial customers. For instance, prices charged the Federal Supply Service by 5 of 12 multiple award schedule contractors were much higher than prices charged other customers who bought less and/or comparable quantities.

This probably happened because the Federal Supply Service did not have procedures for considering the total purchases expected under a contract when evaluating the prospective contractors' offers and negotiating contract prices. As a result, the Federal Supply Service did not obtain the volume discounts normally available to other customers under annual aggregate purchase agreements, original equipment manufacturers' agreements, and individual large quantity orders. Had the Federal Supply Service obtained prices comparable to what other customers received, the Government could have saved about \$1.2 million on purchases totaling \$11.2 million from the five contractors. (See pp. 3 to 8.)

For example, the Government purchased 6,917 units of equipment from a contractor and received discounts ranging from 3 to 8 percent for cash and 2 percent for repair credit. Other customers received 18 percent discounts when they purchased the same equipment in excess of 3,000 units. The Government paid \$175,000 more because of the lower discounts. (See p. 4.)

Although sales from Federal Supply Service contracts amounted to \$840 million, contractors' proposals were rarely independently audited. Sales and discount information submitted on 6 of 15 contract proposals

was not accurate, current, and complete. The veracity of the information submitted was usually not validated by the Federal Supply Service. As a result, the pricing information used by the Federal Supply Service in evaluating contractors' offers and negotiating prices may have been inaccurate. (See pp. 10 to 12.)

To be more effective in negotiating contract prices commensurate with total Government purchasing, the Federal Supply Service should develop procedures to enable it to obtain discounts given by contractors to other customers buying large quantities of goods. (See p. 9.)

The Service should increase its verification of contractors' proposals and its audit coverage of completed contracts. (See p. 12.)

The General Services Administration agreed with GAO's recommendations for increasing its verification of contractors' proposals and audit coverage of completed contracts. It stated that it will work toward increasing efficiency in both preaward and postaward audits. (See p. 13.)

General Services did not agree that procedures need to be developed to obtain quantity price discounts commensurate with total Government procurements. It believes that it negotiates for many individual purchasing officers when it negotiates for the Government rather than for one customer who will buy large quantities.

The General Services Administration needs to reevaluate its role and adopt the concept that it represents the Government as an entity rather than as individual purchasing units.

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ABBREVIATIONS

FSS **Federal Supply Service**
GAO **General Accounting Office**
GSA **General Services Administration**

CHAPTER 1

INTRODUCTION

Under the Federal Property and Administrative Services Act of 1949, the General Services Administration (GSA) is responsible for the procurement and supply of personal property for the use of executive agencies in the Federal Government. GSA assigned the mission of supplying common-use items to the Federal Supply Service (FSS), and in fiscal year 1974, Federal agencies obtained about \$2 billion in goods and services through FSS.

To fulfill its mission, FSS operates several buying programs, the largest of which is the Federal Supply Schedule program. Under this program advertised and negotiated contracts are awarded.

NEGOTIATED MULTIPLE AWARD FEDERAL SUPPLY SCHEDULE CONTRACTS

When Government specifications are not available or when there is a need for several brands of merchandise, FSS awards negotiated contracts. These are called multiple award schedule contracts; FSS awarded about 8,000 of these contracts during fiscal year 1974. Government agencies purchased \$870 million in goods and services directly from suppliers using these schedule contracts.

Exemption from submission of certified cost or pricing data for negotiated contracts

Public Law 87-653, (the Truth-in-Negotiation Act), and the Federal Procurement Regulations require, with few exceptions, that contractors submit certified cost or pricing data for negotiated contracts expected to exceed \$100,000. One exception permits the award of contracts without certification of cost or pricing data when the proposed price is based on established catalog or market prices of commercial items sold in substantial quantities to the general public. Multiple award schedule contracts are negotiated on the basis of this exception.

Prospective contractors must submit commercial catalog or price lists and discounts offered to the Government and all other customers to FSS. Contractors are required to certify that: (1) the prices quoted in proposals are based

on established catalog or market prices, (2) substantial quantities of the items have been sold to the general public at stated prices, and (3) all the data submitted with the offer are accurate, current, and complete up to the date that negotiations are concluded.

Defective pricing

FSS contracts include a price reduction clause which provides that price reduction or special sales by contractors during the contract period must also be offered to the Government, and that the Government reserves the right to audit the contractors' books and records to verify prices they submit. A price refund is provided for when a contractor is found to have submitted defective market- or catalog-pricing data that resulted in an increase in the prices paid.

Benchmark discount technique

In selecting multiple award schedule contractors, FSS uses a benchmark discount procurement technique. Under this procedure FSS selects a benchmark contractor after considering, among other things, the amount of discount offered on catalog prices, the contractor's ability to handle volume sales, and its ability to provide reasonably complete product lines. All prospective contractors meeting or exceeding the benchmark contractor's offer can be awarded a contract that is then listed on a Federal Supply Schedule.

Maximum order limitations

Multiple award contracts specify maximum order quantities to limit the size of individual orders to that contemplated by FSS when discounts were negotiated. FSS attempts to negotiate better prices for orders that exceed the maximum limitation. The limitation, which varies with each schedule, was as high as \$500,000 on the schedules we reviewed.

SCOPE OF REVIEW

The objective of our review was to determine if GSA's procurement practices resulted in fair and reasonable prices.

We analyzed 16 Federal Supply Schedules (app. I) involving sales of \$480 million and reviewed 15 contracts awarded to 12 contractors whose sales to the Government were about \$69 million. We also reviewed records of the FSS Central Procurement Office and GSA Region 9, San Francisco, California.

CHAPTER 2

NEED TO NEGOTIATE PRICES COMMENSURATE WITH GOVERNMENT'S VOLUME OF PURCHASES

We found that prices negotiated by the Federal Supply Service with 5 of the 12 contractors we audited were substantially higher than prices received by other customers who bought similar or even fewer quantities. This occurred because FSS did not consider discounts offered commercially under annual aggregate purchase agreements, original equipment manufacturer agreements, and individual large quantity orders. Had FSS obtained prices comparable to what other customers received, annual savings to the Government for purchases of the products we reviewed from the five contractors would have amounted to about \$1.2 million on purchases totaling \$11.2 million.

BETTER PRICES AVAILABLE TO OTHER CUSTOMERS UNDER ANNUAL AGGREGATE PURCHASE AGREEMENTS

We found that three schedule contractors had agreed to give lower prices to other customers based on total annual purchases. The Government had not obtained similar agreements with the three contractors. Instead, the Government's agreements provided for discounts depending upon the size of each individual order rather than on total annual purchases. With aggregate purchase agreements, the Government could have saved about \$412,000.

The following three examples show the disparity between the discounted prices given to FSS and those given to other customers under annual aggregate purchase agreements.

Example A

For one class of equipment, the Government's purchase from a contractor during the period November 1, 1973, to October 30, 1974, totaled \$4,356,000. The price negotiated by FSS reflected a 2- to 3-percent cash discount and a 2- to 3-percent repair credit. Other customers were given annual progressive cash discounts up to 8 percent where the dollar volume exceeded \$500,000. Since the dollar volume of the Government's procurement was more than eight times this total, it seems reasonable that FSS would have requested comparable discounts. Had the Government been given the 8-percent

discount, there would have been an estimated \$119,000 savings on purchases of the equipment during the 1-year period.

In another instance, the Government's aggregate purchase of three other equipment models from the same contractor during a 1-year period totaled 6,917 units at \$2,121,000. FSS negotiated a 3- to 8-percent cash discount and a 2-percent repair credit. Other customers were given discounts amounting to 18 percent when the quantity procured exceeded 3,000 units annually. Since the Government procured more than twice the 3,000 unit requirement, it seems reasonable to expect that FSS could have obtained comparable discounts. Had the Government been given the 18-percent discount, there would have been an estimated \$175,000 savings on purchases of this equipment during the 1-year period.

Example B

Under another contractor's annual purchase agreement, some customers were given a 7-percent discount when annual purchases exceeded 16 or more units of equipment. The FSS contract provided for a 7-percent discount when six or more units were procured on a single order. A 3-percent discount was for a single order for less than 6 units. Of the 4 months sales we reviewed, there were no instances where the Government qualified for the higher discount by ordering six or more units on a single order. However, one Government customer alone purchased 19 units during the 4 months. Had the Government been afforded comparable aggregate discount treatment, we estimate there could have been an annual savings of \$50,000.

Example C

A third contractor also gave large aggregate volume customers more favorable prices than those given to FSS. For example, a commercial firm agreeing to purchase a minimum of \$110,000 to \$158,000 of a series of products during a 1-year period was given an 18-percent discount off list price. Government customers purchased in the aggregate \$848,000 of the products from the contractor in fiscal year 1974. On an individual order basis, a progressive discount was provided in the FSS contract. Discounts ranged from 7 percent to 19 percent depending on the size of the individual order. The Government

most frequently ordered in quantities which resulted in a 7- to 12-percent discount. Had the Government been given discounts on an aggregate basis comparable to the commercial firm, we estimate from \$68,000 to \$110,000 would have been saved on the fiscal year 1974 purchases.

FSS has not sought the higher discounts available under aggregate purchase agreements nor developed a procedure to apply this technique because it considers aggregate quantity discounts outside the scope of its contracts. Since each Government agency orders individually and directly from the contractor, FSS believes each order stands on its own. FSS's evaluation of the reasonableness of contractors' offers and negotiation of contract prices are, as a result, based on individual purchase orders, not on the total amount of purchases by the Government.

BETTER PRICES GIVEN OTHER CUSTOMERS
DESIGNATED AS ORIGINAL EQUIPMENT
MANUFACTURERS

An original equipment manufacturer is defined as a customer who purchases an item for integration into its own product for resale. Although "original equipment manufacturers" quantity discounts were limited to customers who incorporated the contractor's products into their own products for resale, two contractors stated that they did not offer FSS these discounts. We found that FSS accepted this policy without questioning it. Had FSS negotiated comparable discounts from the two contractors, there would have been an annual savings of about \$614,000 to the Government.

We examined records at contractors' plants and at FSS procurement offices to determine (1) how discounts negotiated by FSS compared with those available to original equipment manufacturers and (2) how FSS contracts compared with original equipment manufacturers' purchase agreements.

Examples of more favorable prices available
to original equipment manufacturers

Example A

The aggregate discounts made available by this contractor to original equipment manufacturers exceeded the highest discounts available to the Government under FSS contracts by up to 22 percent. Allowing for the cash discounts and

service credits negotiated by FSS, we estimate that the Government would have saved \$520,000 had it received aggregate discounts comparable to those available to original equipment manufacturers for the period November 1, 1973, through October 31, 1974. For some product groups, the Government received less than half the quantity discount available to original equipment manufacturers even though the Government purchased more than ten times the amount required to qualify for the original equipment manufacturers' discount.

Product group	Discount to Government (percent)	Original equipment manufacturer discount (percent)	Potential savings to Government at original equipment manufacturer (discount)
1	6	13	\$314,000
2	3	25	123,000
3	5	23	54,000
4	3	20	24,000
5	3	16	<u>5,000</u>
Total			<u>\$520,000</u>

Example B

This contractor's discounts available to original equipment manufacturers were based on the quantity of specific groups of products purchased in the aggregate over a 12-month period. For one series of products, the original equipment manufacturers' discounts ranged from 15 to 42 percent.

During the first 8 months of fiscal year 1974, Government customers purchased 73 units within one product group at the 18-percent discount negotiated by FSS. The original equipment manufacturers' discount schedule offered a 35-percent discount on purchases of 50 to 124 units over 12 months. We estimate the Government would have saved \$94,000 had FSS negotiated aggregate discounts comparable to those available to original equipment manufacturers.

Similarities in FSS contracts and original equipment manufacturer purchase agreements

A comparison between purchase agreements with original equipment manufacturers and contracts with FSS showed that

both agreements were for 1 year and did not commit the buyer to a set quantity or amount of purchase. Under the contractor's original equipment manufacturer agreement, the buyer estimated purchases for the year, and discounts earned were adjusted to reflect the total purchases for the year. In one case penalties were assessed if estimated quantities were not purchased.

The primary differences in the agreements were shipping and warranty terms. The warranty given the Government provided for a 12-month coverage on parts and labor, while other customers were given 12 months' coverage on parts and only 3 months' on labor in one case or 15 months' coverage on parts and labor in another case. Prices negotiated with the Government did not include shipping charges, while other customers paid for shipping costs. While these factors resulted in additional costs on Government sales in some cases, we do not believe they compensated for the greater discounts given the original equipment manufacturers.

FSS considers original equipment manufacturers' discounts outside the scope of its contracts

FSS has stated that original equipment manufacturers' discounts do not apply to procurements by the Government. In explaining its position, FSS stated that the Government does not satisfy the contractor's definition of an original equipment manufacturer, and quantities specified in the contractor's discount schedule for original equipment manufacturers exceeded the maximum order limitation established for the FSS contract.

In our opinion, the fact that the Government does not function as an original equipment manufacturer is not justification for failing to obtain comparable quantity price discounts. Consequently, the Government may be paying for an unfair share of a contractor's profit and, in effect, subsidizing the contractor's sales to original equipment manufacturers.

We further believe the FSS maximum order limitation on products ordered is not adequate justification for eliminating consideration of original equipment manufacturers' discounts when negotiating prices, particularly since FSS establishes the maximum order limitation and can adjust it to serve its needs. Furthermore, the quantity discounts given to original equipment manufacturers were in recognition of customers' total annual purchases instead of single order purchases. Further, another division of GSA, the Automated

Data and Telecommunications Service, considers original equipment manufacturers' discounts when negotiating multiple award schedule contracts and believes such discounts are within the scope of its contracts.

COMPARISONS BETWEEN SCHEDULE AND NON-SCHEDULE PROCUREMENTS FROM CNE CONTRACTOR

The U.S. Forest Service, which was exempt from using the applicable schedule, obtained list price discounts averaging approximately 40 percent on a \$387,000 procurement from one contractor. The procurement was advertised and the contract was awarded to the low bidder. Had the Forest Service used the FSS contract negotiated with this contractor, it would have received only a 15-percent discount and paid an additional \$161,000.

The State of Idaho also obtained a 30-percent discount on a \$152,000 competitive procurement from this contractor. Had Idaho obtained the 15-percent discount negotiated by FSS, Idaho would have paid about \$38,000 more.

The State of Illinois obtained a 21-percent discount on a \$334,000 procurement from this contractor. The same purchase at the negotiated FSS contract price would have been \$23,000 higher.

On June 21, 1974, the U.S. Secret Service purchased \$412,000 in equipment using the FSS contract with the subject contractor. Had prices comparable to those obtained by the Forest Service and States been available, the Secret Service could have saved \$73,000 on the purchase price.

During April 1974, the U.S. Customs Service placed orders totaling \$441,000 with the FSS subject contractor for equipment similar to that purchased by the Forest Service and States. Had prices comparable to those obtained by the Forest Service and States been available, the Customs Service would have saved \$78,000.

CONCLUSIONS AND RECOMMENDATIONS

We found the annual amount of Government purchases from selected contractors was comparable to or greater than other customers', but the Government paid higher prices because it obtained quantity discounts based on individual orders rather than on aggregate orders.

To more effectively negotiate multiple award schedule contract prices, we recommend that FSS develop procedures to enable it to obtain aggregate and original equipment manufacturers' discounts and/or refunds normally made available by a contractor to other customers. The procedures should provide for (1) the evaluation of the reasonableness of prospective contractors' offers and (2) the recognition of the amount of annual purchases expected under a contract.

CHAPTER 3

NEED FOR ACCURATE AND COMPLETE

SALES INFORMATION

The proposals for 6 of the 15 contracts we reviewed did not contain complete and accurate information. Also, none of the proposals had been audited even though FSS relied on them to evaluate offers and negotiate prices.

PROPOSALS CONTAINED INCOMPLETE SALES INFORMATION

Contractor proposals did not always show the extent of discounts contractors gave to other customers. A comparison of contractor sales records showed numerous instances of better discounts given to other customers than to FSS. Had FSS been aware of these discounts, it might have been able to negotiate more reasonable prices for the Government. The following two examples show the types of discounted prices that were not disclosed by contractors and the possible effect on prices negotiated by FSS.

Example A

One contractor's submission disclosed a range of quantity discounts given to dealers, commercial customers, and State and local governments. However, the contractor failed to disclose that better prices were given certain customers under contractual agreements, extended promotional sales, and supply schedule agreements. When we questioned this lack of disclosure, the contractor maintained that such sales were outside the scope of the company's general catalog price lists and therefore were not disclosed to FSS.

In reviewing the contractor's detailed sales records, we noted 57 contractual agreements for special prices. At least 37 of these agreements covered sales of one item which was sold in significant quantities to the Government, often at higher prices. Our sample analysis of non-Government sales of the item indicated 88 percent of the sales were under contractual agreements for special prices. Thus, FSS negotiated a price for the item unaware of sales and discount information relating to the great majority of the contractor's commercial sales. Had the Government received a price comparable to that

given by the contractor to another customer, we estimate \$84,000 would have been saved on the Government's \$858,000 fiscal year 1974 procurement of the item through the schedule contract.

Government orders of all products from this contractor under the FSS contract reviewed totaled \$5.1 million in fiscal year 1974. A full disclosure of customer prices and discounts by the contractor might have resulted in the negotiation of more reasonable discounts and significant savings to the Government.

Example B

Another contractor failed to disclose customer discounts in his submission as required by FSS. In reviewing the contractor's detailed sales record, we noted that 28 percent of non-Government sales of four selected items were at discounts up to 16.6 percent off catalog list price. When we questioned the contractor on its failure to disclose this information, we were told these discounts were not disclosed because they were viewed by the company as temporary price reductions.

In this instance, the frequency and nature of discounted sales demonstrated that it was the contractor's standard marketing practice to give customers discounts when competitive factors in the marketplace made it necessary in order to make a sale. These discounts should have been disclosed in the contractor's submission, along with specific information on the discounts given. In the absence of such a disclosure, FSS negotiated the Government's price based on the premise that the contractor only sold equipment at full catalog list price.

Government activities annually purchase about \$1.4 million in products from this contractor under the applicable schedule contract. Had the Government received discounts comparable to those given the contractor's most favored customer, we estimate \$155,000 would have been saved on the price of these purchases.

We brought these examples to the attention of FSS, and as a result, FSS has taken preliminary action necessary to obtain refunds from the contractors under the price reduction clauses included in FSS contracts as discussed on page 2.

PROPOSALS WERE RARELY INDEPENDENTLY
VALIDATED FOR ACCURACY, CURRENCY, AND
COMPLETENESS

FSS contracting officials stated that an independent verification of a contractor's proposal is only requested when there is reason to suspect a defective proposal. They further stated that they have no program to systematically verify the data contained in contractors' proposals.

The GSA Office of Audits and the Defense Contract Audit Agency provide audit assistance to contracting officers. Postaward audits are made by the Office of Audits, but pre-award audits are usually obtained from the Defense Contract Audit Agency. During fiscal years 1973 and 1974, 25 pre-award audits were performed, and recommended savings from these evaluations totaled \$962,000. Eighteen postaward audits performed during fiscal years 1973 and 1974 resulted in GSA claims amounting to \$1,422,979.

None of the proposals of the 15 contracts we reviewed had been audited. Representatives of the Office of Audits advised us that lack of staff has caused them to postpone or waive many other requested audits.

CONCLUSIONS AND RECOMMENDATIONS

Although sales from FSS contracts amounted to \$870 million for fiscal year 1974, contractors' proposals were rarely independently audited for accuracy, currency, and completeness. We found that 6 of 15 proposals we examined were inaccurate or incomplete with respect to discounts. In addition, the limited number of audits performed on multiple award contracts resulted in recommendations for savings and recoveries of about \$2.4 million.

Accurate, current, and complete sales and marketing data is essential to enable the Government to negotiate fair and reasonable prices. Therefore, we recommend that FSS increase its independent verification of contractors' proposals and audit coverage of completed contracts.

CHAPTER 4

AGENCY COMMENTS AND OUR EVALUATION

GSA agreed with our recommendation that FSS needs to increase its verification of contractors' proposals and audit coverage of completed contracts. It stated that it will work toward increasing efforts in both the preaward and postaward audit areas.

However, GSA did not concur with our recommendation concerning the need to develop procedures to obtain aggregate quantity discounts normally made available by certain contractors to other customers. A copy of GSA's comments are included as appendix II to this report.

GSA stated in its response that it did not believe conclusions applicable to the entire multiple award program could result from a review of 15 contracts, which represents only .18 percent of the total 8,000 contracts. The 8,000 multiple award schedule contracts GSA negotiated in fiscal year 1974 resulted in purchases by Government agencies amounting to \$870 million. We reviewed and/or discussed with contracting officials Federal purchases of goods and services amounting to over \$480 million, which represent 56 percent of the total procurements in the multiple award program for fiscal year 1974. We believe this coverage does allow for a conclusion to be drawn on the management of the multiple award program.

GSA also raised some important problems which will have to be overcome if aggregate quantity discounts are to be obtained. At the root of these problems is GSA's belief that, in negotiating multiple award schedule prices, the Government is not one customer but several thousand customers (i.e., individual purchasing officers). This opinion is demonstrated in GSA's comments to our report draft where it states "* * * the multiple award program is a competitive means of procuring small quantities of commercial products * * *." But multiple award program procurements in fiscal year 1974 totaled \$870 million. We therefore believe the program should not be viewed as applicable for only "small quantities of commercial products." Such a concept weakens the Government's bargaining position during negotiations because it fails to fully recognize that the Government collectively buys large

quantities. We believe GSA's philosophy has contributed to those instances where Government prices are not comparable to those obtained by commercial firms purchasing from the same sources in smaller aggregate quantities.

GSA justifies its philosophy on the basis that it is not in a position to guarantee any minimum procurement figure at the time of negotiation. Although the Government collectively and frequently purchases several times the amount of items guaranteed by commercial firms, GSA feels that the funding and administrative problems connected with a Government guarantee prohibit the use of guarantees and receipt of Government-wide aggregate quantity price discounts. More specifically, GSA identified the following reasons as justification for its position:

- GSA lacks information necessary to determine the quantity and/or dollar volume which would be applicable to the agreements.
- New complex financial and accounting procedures would be required in order to reimburse a contractor if aggregate quantities specified in an agreement were not attained.
- Provisions for blanket purchase agreements are already provided for in FSS contracts which are the equivalent of aggregate purchase agreements.
- Terms of current FSS contracts may differ from those available to commercial customers under aggregate purchase agreements, and thereby reduce the Government's potential price savings.

The issues raised by GSA do not support the position that aggregate purchase agreements are impractical. There are, no doubt, problems to be overcome, but we believe they can be resolved.

For instance, regarding the lack of information to determine the basis for aggregate discounts, the provisions of current multiple award schedule contracts require a monthly reporting of sales by contractors to FSS. In addition, contractors are required to submit information, with their proposal, of the prior year's sales to the Government and identify any product which is purchased in significant amounts. These reports give FSS information on the aggregate dollar volume of sales to the Government.

The need for new complex financial and accounting procedures to handle adjustments is questionable. For example, if discounts were negotiated on the basis of aggregate Government purchases under the prior year's contracts, the adjustment for aggregate purchase levels attained could be reflected in the contract prices negotiated in the following year.

Regarding GSA's comment on blanket purchases agreements, such agreements, available under multiple award schedule contracts, are not the equivalent of a Government-wide aggregate purchase agreement. Presently, these agreements are handled separately on a fragmented basis by each Government agency, and the Government is not recognized as one customer. Furthermore, the discounts obtained reflect those already negotiated by FSS into the multiple award contract which only involves amounts up to the applicable contract maximum order limitation established for an individual order. Therefore, additional discounts a supplier may provide other customers, in recognition of aggregate annual amounts which exceed the maximum order limitation, are excluded.

Regarding discount terms, GSA indicated that its contracts provide for destination delivery, warranties, and fixed prices which may be more favorable than terms given commercial customers. It also stated that advance payments, multiyear contracts, and contractors' administrative costs associated with maintaining numerous Government accounts may account for a portion of the savings available to commercial customers.

In our review of contractors' sales, we noted the terms of aggregate purchase agreements varied with the customer and contractor. Most commercial agreements did provide for a price which did not include shipping costs while the Government's prices did. Warranty and service provisions varied considerably, and some commercial customers received more extensive terms than the Government, as well as contracts with fixed prices.

FSS's determination of what a reasonable price for the Government is in recognition of aggregate annual purchases should depend on the specific contractor and its marketing practices. Considerations during the negotiation process should include (1) discounts, (2) terms of aggregate purchase agreements the contractors afford other customers, and (3) how these terms compare to those being offered the Government.

FEDERAL SUPPLY SERVICE MULTIPLE AWARDSCHEDULES REVIEWED

<u>Schedule number</u>	<u>Commodity</u>	<u>Fiscal year 1974 schedule sales</u> (millions)
36 I	Printing plates and solutions	\$ 6.8
36 II A & B	Printing/copying equipment	10.3
36 IV	Printing/copying equipment	138.4
58 III B	Audio and video tape recorders	24.2
58 VII	Nontactical two-way radios	32.2
62-67 I	Electric and photographic lamps	20.6
65 II B	Surgical instruments and supplies	13.9
65 II C	Dental equipment	10.5
65 II D	Medical/dental equipment	4.3
66 II C	Microscopes, centrifuges and other laboratory equipment	10.1
66 II F	Operational audio amplifiers	51.3
66 II H	Measuring and test instruments	43.1
67 III B	Photographic supplies	11.7
67 IV B	Photographic equipment	19.2
71 X A & B	Special purpose and classroom furniture	18.3
74 II & III	Office machines	<u>65.4</u>
Total		<u>\$480.2</u>

UNITED STATES OF AMERICA
 GENERAL SERVICES ADMINISTRATION
 WASHINGTON, DC 20405



November 5, 1976

Honorable Elmer B. Staats
 Comptroller General of the United States
 General Accounting Office
 Washington, D.C. 20548

Dear Mr. Staats:

As requested in the August 23, 1976, letter from R. W. Gutmann, Director, Procurement and Systems Acquisition Division, we have reviewed the draft report to the Congress on "The Need to Improve Federal Supply Service Procurement Practices." As a general comment, the multiple-award program is a competitive means of procuring small quantities of commercial products that have an established market acceptability utilizing the commercial distribution channels. Based on the discount structures available to all other classes of customers, FSS contracting personnel negotiate discounts commensurate with the Government's volume of business and, at a minimum, usually obtain most favored customer status. Detailed comments regarding the competitive nature of the program and the specific recommendations contained in the report are attached.

We do not believe that a review of 15 contracts, which represent only .18% of the total 8,000 contracts, can result in conclusion applicable to the entire multiple-award program. In our opinion, the assumption that these contracts are representative of all contracts is unsupportable. Furthermore, the report indicated that only five contractors were problematic. For the most part, we had previously recognized these contractors as problematic and, specifically, suggested that GAO investigate two of these contractors during their study in order to obtain audit information concerning their commercial discount arrangements. This information has proven to be extremely useful during our contract negotiations. Additionally, the specific examples of procurements cited in your report do not provide sufficient information to determine either the accuracy of projected savings or the validity of the comparisons to our method of procurement.

With respect to the specific recommendation concerning Government-wide aggregate purchase agreements, we have determined that such arrangements are impractical. However, we had previously ascertained that an aggregate purchase agreement was most cost effective at the agency/ordering activity level and, since 1968, our contracts have provided for such agreements.

[See GAO note 1, p. 22.]


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[See GAO note 1, p. 22.]

Finally, we agree that verification of contractors' proposals and audit coverage of completed contracts is desirable and, within existing resource limitations, we will work toward a goal of increasing our efforts in this area.

We appreciate the opportunity to review and comment on the report.

Sincerely,


TERRY CHAMBERS
Deputy Administrator

Enclosure

GSA Fact Sheet
October 1976

COST EFFECTIVENESS: MULTIPLE-AWARD PROGRAM

Contrary to the statement contained on the cover page of the draft report, the multiple-award program has been formulated in such a manner to insure that the Government does obtain common-use items at the lowest possible cost. The multiple-award program, as a method of supply, utilizes commercial distribution channels and enables Federal agencies to purchase commercial, off-the-shelf, products that have an established market acceptability and, as such, provides an effective vehicle for implementation of the OFPP policy concerning procurement and supply of commercial products. The OFPP recognizes that utilization of commercial distribution channels for the procurement of such products reduces costs associated with requirement and specification development, purchasing and contracting, warehouse operations, transportation, distribution, administrative handling and inventory investment. Furthermore, the program provides for a high level of competition in that it takes advantage of or fosters competition at three levels to insure that the Government obtains the lowest price possible.

The first level of competition "coat-tails" commercial market forces. In a free economy it is an economic axiom that the commercial market is an accurate and sometimes a ruthless evaluator of what a product is worth. Apart from short-term aberrations that may attend advertising campaigns or consumer fads, market forces eliminate poor products and the surviving good products usually sell at a price commensurate with relative worth. Hence, if several firms offer items of dissimilar manufacture to serve a similar purpose, the market will generally select out the better items and reflect its decisions by purchasing the item at the prices established through competition in the open market.

At the second level competition, it is precisely the above forces that are brought to bear when we negotiate multiple award contracts pursuant to our benchmark negotiation procedures. In this regard, offers for similar items are grouped according to market practices; e.g., whether or not manufacturers sell direct or through dealers, and are then required to meet benchmarks in the form of discounts from the same prices that have been subjected to the forces of the commercial market. Based on the discount structures available to all other classes of customers, FSS contracting personnel negotiate discounts commensurate with the Government's volume of business and, at a minimum, usually obtain most favored customer status.

The third level of competition extends into the ordering process. FPMR 101-26.100-1 directs ordering agencies to purchase their requirements from the lowest-priced source which provides items that will adequately serve the functional end-use purpose. The FPMR further requires written documentation to support orders at other than the lowest prices in cases where the value involved exceeds \$250. It is the intent of these regulations to safeguard against capricious ordering of higher priced items for reasons of preference.

The program also has protective devices. First, any price reduction given to a customer for a requirement within the ordering limitations of the contract must be passed on to all Federal customers. Second, requirements in excess of these ordering limitations must be contracted by formal advertisement unless one of the exceptions permitting negotiation applies. More detailed information relative to maximum order limitations is contained in our comments concerning GAO Recommendation 2.

GAO RECOMMENDATION 1 [See GAO note 2, p. 22.]
(page 11, para. 2)

We recommend that FSS develop procedures to enable it to obtain aggregate and original equipment manufacturer discounts and/or refunds normally made available by a contractor to other customers.

During the last seven years, we have endeavored to develop a method of incorporating Government-wide aggregate purchase agreements in our Schedule program, and have determined that such agreements are impractical. The primary restraints to such agreements are as follows:

1. We lack the necessary information to determine the quantity and/or dollar volume to be applicable to the agreements. If the aggregate quantity requirement could be determined from the approximately 10,000 ordering activities, a definite quantity procurement might be more appropriate than the multiple-award contract which is designed to satisfy small day-to-day requirements of the ordering activities.

2. The multiple-award program is built around competitive commercial marketing practises through which contractors compete with each other for customer agency orders. If a contractor, in effect, has a guaranty of a quantity for which an increased discount has been provided, the contractor must compensate for this added discount. Normally, this compensation would be in the form of a reduced sales effort which would jeopardize attainment of the aggregate quantity in the agreement.

3. Nonattainment of the aggregate quantity on which the discount is based would result in higher prices to the Government and would require complex financial and accounting procedures to effect the necessary reimbursement to the contractor. Resources necessary to monitor the Government's progress toward ordering the aggregate quantity and to validate potential reimbursements to the contractor are not available.

Notwithstanding the above, some agencies/ordering activities have been able to project their requirements with enough accuracy to warrant issuance of an aggregate purchase agreement. In this respect, an agency or ordering activity, which uses common funds and has greater control over what is ordered, can manage the complexities outlined above. Accordingly, since 1968, multiple-award contracts have included provisions for agencies/ordering activities to enter into blanket purchase arrangements which are the equivalent of aggregate purchase agreements. These arrangements permit the agency/ordering activity to obtain the highest discounts available under the contract during the entire contract period regardless of the size of individual orders.

With respect to commercial aggregate purchase agreements and Original Equipment Manufacturer (OEM) discounts, we require potential contractors to provide information on the extent of these arrangements. Contracting officers use this information in their efforts to negotiate contracts which will result in comparable savings for Federal agencies.

The examples of aggregate purchase agreements and OEM discounts cited in the report do not provide sufficient information for us to adequately compare the benefits of these commercial arrangements to benefits available from our contracts. Consideration of the following factors could reduce GAO estimated saving substantially or eliminate them entirely:

1. Destination delivery. Normally, GSA prices are f.o.b. destination, whereas commercial prices are f.o.b. origin.

2. Warranties. Warranty and service provisions contained in Schedule contracts normally provide more favorable terms to the Government than to commercial customers. Specifically, equipment sold to an OEM is included in a system of the OEM or is sold by the OEM under its brand name as an accessory. In either case, the unit usually becomes the responsibility of the OEM for service and warranty.

3. Fixed prices. GSA contracts provide for fixed prices during the entire contract period, usually one year. Fixed prices may not be available through commercial aggregate purchase agreements or to OEMs.

4. Advance payments and multi-year contracts. By law, these two procedures cannot be incorporated into Schedule contracts and may account for a portion of the savings available to commercial customers.

5. Contractor administrative costs. Costs associated with maintaining up to 10,000 Government accounts are greater than the cost of maintaining a single aggregate purchase agreement or OEM account. These higher costs are reflected in the discounts available to the Government.

GAO RECOMMENDATION 2

[See GAO note 1, p. 22.]

[See GAO note 1.]

GAO RECOMMENDATION 3
(page 15, para. 3)

We recommend that FSS increase its verification of contractors' proposals and audit coverage of completed contracts.

We agree with the recommendation and, within existing resource limitations, will work toward a goal of increasing our efforts in both the pre-award and post-award audit area.

[See GAO note 2.]

GAO note 1: Portions of this letter have been deleted because they are no longer relevant to the matters discussed in this report.

GAO note 2: Page references in this appendix refer to the draft report and do not necessarily agree with the page numbers in final report.

PRINCIPAL OFFICIALS OF THE
GENERAL SERVICES ADMINISTRATION
RESPONSIBLE FOR ADMINISTERING
ACTIVITIES DISCUSSED IN THIS REPORT

	<u>Tenure of office</u>	
	<u>From</u>	<u>To</u>
ADMINISTRATOR, GENERAL SERVICES ADMINISTRATION:		
Robert T. Griffin (acting)	Feb. 1977	Present
Jack M. Eckerd	Nov. 1975	Feb. 1977
Dwight A. Ink (acting)	Oct. 1975	Nov. 1975
Arthur F. Sampson	June 1972	Oct. 1975
COMMISSIONER, FEDERAL SUPPLY SERVICE:		
Wallace H. Robinson, Jr.	Feb. 1976	Present
J. H. Bolton (acting)	Nov. 1975	Feb. 1976
Michael J. Timbers	June 1973	Oct. 1975
ASSISTANT COMMISSIONER FOR PROCUREMENT:		
Frederick B. Bunke	June 1973	Present